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C O N F I D E N T I A L SECTION 01 OF 03 SANAA 000073

SIPDIS

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TAGS: ECON EFIN KMPI YM ECON COM
SUBJECT: COMMERCIAL BANKS IN YEMEN: WHOM CAN THEY LEND TO?

REF: SANAA 56

Classified By: Charge d'Affaires Nabeel Khoury for reasons 1.5 b and d.

¶1. (U) Summary. Commercial banks are underutilized in Yemen, slowing the flow of capital and preventing investment in domestic development. Few Yemenis deposit their savings with banks, and loans are available only to an elite few. The lack of lending stems from a weak judicial system, poorly defined property rights, the absence of a viable credit rating system, and mutual suspicion between banks. During a MEPI-sponsored visit by the Financial Services Volunteer Corps, the delegation visited most of Yemen,s major commercial banks, as well as the Ministry of Finance, the Central Bank of Yemen (CBY), and the Aden Development Authority (CBY meetings covered reftel). End Summary.

Banks irrelevant to most Yemenis

¶2. (U) Banking in Yemen is still in its infancy and well below international banking sector standards. There are currently 17 commercial banks, four of which are Islamic and four that are government owned. Of these, only the International Bank of Yemen, Tadhamun, Arab Bank, and the Calyon investment bank can be considered credible banking institutions. The others lack basic capital requirements, the technical capacity to link their branches, or the management expertise to do core banking. The capital base of most Yemeni banks is small, and only three percent of Yemenis hold bank accounts. There are a total of 500,000 accounts in all of Yemen's banks combined, and many of these belong to the same customers. Trust in banks is growing, but low incomes, a cash economy, and the inefficiency of the banking system make banks irrelevant to most Yemeni citizens.

¶3. (U) Lending makes up only a very small part of commercial banking in Yemen. For instance, loans make up only about six percent of the National Bank of Yemen's (NBY) portfolio (formerly the Central Bank of South Yemen). Arab Bank lends only eight percent of total deposits. The NBY, like other Yemeni banks, makes the bulk of its investments, approximately 80 percent, in government T-bills). Barring a complete collapse of the government, these guaranteed investments provide return without risk. Contrary to statements by the CBY (reftel), Ahmed Hamdani, Chairman of Watani Bank, believes that T-bills dry up investments in other projects. Loans in Yemen are approved mostly for trade financing and not for smaller investments, such as home or small business loans. Almost all loans are short-term, usually a year or less, with high interest rates (over 20 percent, with a margin of 10-15 percent), making it difficult for small borrowers to finance investments. Businesses familiar to the banks are able to obtain automatic renewals of short-term loans, allowing them to finance larger investments.

Obstacles to Lending

¶4. (C) Bankers and ROYG officials agree that the biggest obstacle to lending is a weak judicial system. Banks have little confidence that they will be able to collect on delinquent loans when they know such cases may be tied up in court for as long as ten years. Even when the courts rule in their favor, the authorities generally do not enforce collection. Mahdi Alawi, Director of Arab Bank in Yemen, claimed that judges are corrupt, saying a standard bribe is 10 percent of the final award. Even honest judges will often rule that charging interest is against Islam and award lenders only the principle of the loan.

Mafia Tactics

¶5. (C) Because of these obstacles, executives at the International Bank of Yemen (IBY) confessed that they have resorted to "mafia tactics" to collect outstanding loans. There is a Bank Arbitration Center in Sanaa, which is supposed to conduct extra-judicial mediation, but Ahmed al-Absi of IBY said that since borrowers know they can get off the hook in court, it is not widely utilized. As a result, banks lend almost entirely to customers they know

personally. Alawi contended that Yemen needs an entirely new generation of judges that are both honest and schooled in modern commercial law. The Ministry of Finance also acknowledged this problem to FSVC and suggested special banking courts with non-Yemeni judges.

Possession is Nine-Tenths of the Law

¶6. (U) Since property titles are often duplicated or disputed; there is no reliable form of collateral in Yemen. Such property disputes are often resolved by force. The ROYG has not passed a specific law on property and, according to Alawi, Yemen is the only country where it is considered against Islam to use land as collateral. Property holdings are not recognized by the CBY when it calculates a bank's capital ratio (the hard assets a bank has against its liabilities) and the CBY decides how much risk a bank may take on. Since the ROYG does not recognize the legal value of property, neither do banks.

¶7. (C) Banks have few tools to determine the credibility of its customers. Most businesses in Yemen practice poor accounting. Officials at all the banks agreed that local CPAs and tax auditors are widely considered untrustworthy and corrupt, willing to falsify balance sheets in exchange for bribes. There is also no functioning credit bureau. The CBY keeps a blacklist on borrowers who have defaulted, and commercial banks are required to provide this information to the CBY, but the system is not effective. The list only includes bad loans of over 5 million riyals, so there is no information on small borrowers. According to Alawi, powerful figures sometimes physically threaten officials of the CBY and private banks in order to keep their names off the list. Hamdani confirmed this, saying that an independent credit bureau is similarly impossible because of the potential for tribal violence in response to bad ratings. Without a centralized credit bureau, each bank must rely on its own records, which it is unlikely to share.

¶8. (U) Alawi said in many cases banks are their own worst enemies, lending to bad borrowers because of personal friendships, or for fear of losing customers to other banks. The Banking Law forbids insider lending, but this is rarely enforced in the case of character loans.

No lending, no Development

¶9. (U) Ahmed Ghaleb at the MOF boasted that because of the Ministry,s 1997-8 reforms, all Yemeni banks are now liquid. However, liquidity is no longer the main problem. By law, banks are required to be 30 percent liquid, but most are between 60-70 percent because they cannot find reliable places to lend the money they have. This means that Yemeni banks are sitting on cash that could be used to stimulate the dormant economy through lending.

¶10. (U) Officials at the MOF and the CBY say that commercial banks are hurting development with their unwillingness to take any risk through lending. There are few viable businesses, however, to which banks can lend. Applicants rarely have collateral or feasibility studies for their investments. Most are one-man-shows that depend on personal relationships to obtain loans or credit. Alawi said that the ROYG could improve this by establishing real property registries and passing a leasing financing law. That law is currently being drafted at the CBY, but Alawi remained pessimistic about its implementation.

¶11. (C) Development is also hampered by a lack of trust between individual banks, which are afraid to reveal their financial status and therefore will not lend to each other (reftel). Alawi believes this distrust could be eliminated if the CBY had a competent oversight capacity and its auditors were not subject to corruption. (Note: The CBY inspects the banks annually, but their techniques are predictable and little information is released to the public. End Note.)

¶12. (U) Banks have difficulty undertaking joint financing of large development projects, and as result they are generally funded from abroad. This problem is evident in Aden, where Yemeni banks are unable to finance private development projects for the Aden Port and the Aden Free Zone, both critical to Yemen's economic future. Representatives of Aden banks formed a committee to tackle this problem, but according to Mohamed al-Muflehi at the Aden Local Development Office, so far the banks have failed to overcome their mutual distrust. The lack of cooperation is especially evident in the bankers associations, each of which Hamdani reports, operates like the personal domain of the powerful banking families. Such rivalry prevents the associations from reforming their own practices or lobbying the ROYG.

Attempts at Modernization

¶13. (U) Comment: Yemen's major banks are attempting to find strategies to encourage Yemenis to use the banking system. NBY is offering new high-yield investment funds. Watani is looking to offer 2-3 year medium-term loans to small and medium-sized businesses. IBY is opening ATMs and launching point-of-sale purchases as well as debit cards. Many banks are offering Islamic lending products (common in GCC countries) as a means of avoiding prohibitions against interest. Some banks now cooperate with government ministries to offer medium-term loans, with monthly deductions taken directly from employees' paychecks. These efforts, however necessary and well meaning, are unlikely to have much of an impact without major improvements in the financial system, including rule-of-law, effective CBY oversight and modernization, and a viable credit system to support lending. End Comment.
KHOURY